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SENSITIVE

STATE FOR EB/IFD, WHA/EPSC, AND WHA/CEN
TREASURY FOR DDOUGLAS
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TAGS: EFIN ECON EINV PGOV HO
SUBJECT: HONDURAS: FAST-FOOD BOOM CONTINUES AS FIRST
QUIZNOS OPENS

¶1. (SBU) Summary: Honduras, fast-food sector continues to flourish and, with new entrant &Quiznos Sub,8 remains dominated by U.S. franchises. Quiznos sees strong growth potential in Honduras, based on the strong market acceptance of U.S. brands and continuing economic growth. Quiznos did not, however, benefit from an extremely generous tax exemption scheme under which many of the early entrants to the sector (based on the questionable justification that fast-food franchises boost tourism) received a ten-year tax holiday on income taxes, and a perpetual exemption from import duties on capital equipment and process inputs. Those laws have been tightened to offer benefits only to true participants in the tourism sector, but it appears the early entrants ) overwhelmingly composed of a small group of economic elites ) will continue to receive those benefits and continue to earn windfall profits. End Summary.

¶2. (SBU) On September 23, EconChief and Ambassador participated in the ribbon-cutting ceremony for the first Quiznos franchise in Honduras. In the works for over a year, the new outlet cost $350,000 to construct and has the largest footprint of any franchise outside the United States. Quiznos representatives would not divulge the cost of the national rights to the chain in Honduras, but indicated it was &substantially more8 than the construction fees spent to date. The outlet was the brainchild of Luis Rock, 23-year old scion of Antonio Rock, the largest authorized distributor of major motion pictures for over 40 years in Honduras, a partner in the Multiplaza chain of movie theatres, and now the new franchise holder for Quiznos operations in Honduras. The younger Rock, a recent U.S. college graduate in Marketing and Finance, serves as the Manager of the flagship store.

¶3. (SBU) The franchise agreement calls for the construction of seven outlets countrywide, at a pace of at least two new outlets per year (and a franchise fee of over $20,000 per store). The aggressive expansion plan by Quiznos Honduras is mirrored in other countries in the region, according to Richard Eisenberg, Latin American Regional President for Quiznos. Eisenberg told EconChief that Quiznos is rapidly expanding beyond its regional base in Costa Rica, where they already have nine franchises. Honduras is the first to open, but will be followed in quick succession by two stores in El Salvador later this year, and one in Guatemala early next year. In all three countries, Quiznos is following a similar business model, according to Pablo Fernandez, Franchise Expansion Manager for Quiznos. Fernandez told EconChief that Quiznos prefers to identify a strong group or company in-country with whom they can sign multi-unit deals for continued strong growth. Both the Salvadoran and Guatemalan contracts include multi-year, multi-unit deals, Fernandez said.

¶4. (SBU) At first the Honduran fast-food market might appear saturated, yet receptivity to new chains remains high. According to Eisenberg, the economic returns per outlet in Honduras are projected to be among the best in Latin America. Quiznos views this as a significant opportunity to capture market share and remains enthusiastic about future prospects. In the U.S., Quiznos reports it has risen to become the number one provider of sub sandwiches, and expects to do the same in Honduras. The entry of Quiznos should therefore introduce some additional competition into the fast-food market in Honduras, particularly for Jorge Siwady,s Subway franchises.

¶5. (SBU) Though there are myriad U.S. franchised fast-food operations in Honduras already, most are owned by only a handful of firms or families. Eduardo Kafati, for example, holds franchise rights to Burger King, Church,s Chicken, Popeye,s Chicken and Biscuits, Little Ceasars Pizza, Baskin-Robbins, and Dunkin Donuts. Similarly, Roberto Larach (publisher of two major newspapers and a cousin of the Canahuati family) holds the rights to Pizza Hut, Kentucky Fried Chicken, and the Pepsi distributorship in San Pedro. Wendy,s Hamburgers and casual dining restaurant Applebees are owned by shopping-mall magnate Raymond Malouf. The price

impacts of this apparent market concentration vary with the degree of competition: Little Ceasars, Dominos, and Pizza Hut -- fierce competitors -- have reasonable prices and frequently offer package deals and other specials. The same rivalry can be seen between Burger King and McDonalds. Wendy,s, inexplicably, is nearly as expensive as in the U.S., and Dunkin Donuts, at nearly one dollar per donut, is even more expensive in Honduras than in the U.S. Quiznos, operator, the Rock family, is a new entry to this sector, but is not without other connections: Antonio Rock is brother-in-law to the powerful Canahuati clan, the family of Ambassador to the U.S. Mario Canahuati and owners of a multi-million dollar maquila operation.

¶6. (SBU) Most fast-food franchises arrived in Honduras within the last decade. Two factors seem primarily responsible for this rapid growth: First, the market, fed by a growing economy and strong remittances growth, remains a voracious consumer of fast food. The popularity of U.S. chains in particular could be the result of the estimated one million Hondurans currently resident in the U.S. and the large numbers of Hondurans who have studied in the U.S. or who visit there regularly and who are therefore familiar with these brands. Second, until recently the tax law encouraged this expansion of fast food chains by granting them 10 year tax holidays on income taxes and near blanket waivers on duties and taxes (using the dubious rationale that they boost tourism and therefore should get the same tax breaks as hotels.)

¶7. (SBU) On October 1, EconChief met with Vice Minister of Commerce Salvador Melgar Ascencio, one of the drafters of the tax exemption, to discuss its origins and current status. Melgar said that one of the first tax exemptions was granted to an early Burger King franchise. To qualify, a business had to demonstrate that it was in a site of archeological, historical, or architectural interest -- Burger King failed that test on all counts. Nevertheless, Melgar said, the exemption was granted. This &acquired right8 quickly caught on and was granted to other similar franchises. In its original form, the tax benefit was justified as promoting tourism and promoting the import of capital goods that would encourage growth of the sector.

¶8. (SBU) The benefits were subsequently memorialized in the Tourism Incentive Law of December 18, 1998, which granted ten-year tax holidays for tourism-related businesses, and near-blanket waivers on customs and import duties. Melgar lamented the way the implementation had spun out of control, noting that the law was not intended to allow, for example, duty-free importation of foodstuffs. When that law was revised on June 5, 2002, the revision tightened the classes of businesses that could benefit from the exemptions, limiting it to hotels, resorts, tourist transport, handicrafts, tourism promotion, and other clearly related pursuits. Notable by its absence was the fast-food or restaurant sector. While new businesses will not benefit from the old law, Melgar said it was his understanding that those fast-food franchises established under the old law would retain those tax benefits, and, in essence, continue to make windfall profits. Quiznos reportedly did not benefit from the exemptions.

¶9. (SBU) Comment: Post is pleased to see a new U.S. operation enter the market, not only to offer more selection to the consumer, but also to diversify (slightly) the ownership base of the sector. The franchise sector is clearly a very successful U.S. export to Honduras, and Post will continue to support its growth. Post will watch with interest any developments in the tax code regarding fast-food restaurants. Post suspects that as new entrants are forced to compete without benefit of the old tax exemptions, pressure will mount for closing that loophole to existing businesses as well. End Comment.

PIERCE

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